



December 19, 2004

To the Board of Supervisors
County of San Bernardino, California

Ladies and Gentlemen:

We have audited the basic financial statements of the County of San Bernardino (the County) for the year ended June 30, 2004 and have issued our report thereon dated November 19, 2004. In planning and performing our audit of the basic financial statements of the County, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control. We have not considered internal control since the date of our report.

During our audit we noted certain matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies and are summarized as follows:

**UNTIMELY RECONCILIATION AND REVIEW OF WASTE SYSTEMS MONTHLY FAS 370
REPORTS TO BANK DEPOSITS**

OBSERVATION

During our testing of internal controls over the cash management process, we noted that the Waste Systems department had not reconciled and reviewed the monthly FAS 370 report received from general accounting to copies of deposit slips submitted to the Treasurer in a timely manner from July 2003 through April 2004.

RECOMMENDATION

We recommend that the County put procedures in place to ensure that Waste Systems follows established countywide policies and procedures over cash management. This includes the monthly review and reconciliation of the FAS 370 report to copies of deposit slips on a timely basis to ensure cash deposited was recorded by the bank and that general accounting has properly recorded these cash collections to the proper revenue accounts on the general ledger.

MANAGEMENT'S RESPONSE

With the additional staff authorized for this fiscal year, the Waste Systems Department has placed a priority on reconciliation of cash. Waste System's cash is currently reconciled through January 2005. It is the intent of the division to comply with all Internal Control and Cash Manual procedures.

MAINTENANCE OF HUMAN RESOURCE FILES

OBSERVATION

During our testing of the Human Resource process, we noted several instances whereby employee's files were incomplete or missing. It is noted the County implemented a digital archiving system in prior years to store employment records. Additionally, the County was utilizing a legacy digital archiving system during FY 1996-1999. However, we noted the system failed and data was lost as a result of the system failure. As a result, original supporting records required as part of the audit process could not be provided.

RECOMMENDATION

We recommend that the County design procedures to ensure that employee personnel files exist and are kept current and support the status and pay rate of employees. By maintaining employee files current it will reduce the risk of errors and irregularities occurring in payroll and going undetected by management.

MANAGEMENT'S RESPONSE

When data files are lost or missing we have a second individual complete an additional, independent search in an attempt to locate the information. Out of the 11 documents that were not found at the time of the audit, we have since located 4 in our current imaging system or in the old legacy imaging system's backup discs. Once documents are scanned or transferred to microfilm and audited, they are shredded. Unfortunately, the old legacy imaging system became very unstable after the missing documents were scanned and destroyed, and several of these discs became unreadable. The legacy system was so old, it was also no longer supported by any vendor maintenance assistance, so there was no way to retrieve or search for any of the missing data. Since the documents were shredded after scanning, they cannot be re-created. The data on the legacy system discs that were still readable was transferred to CDs, and back up copies were made. We also sent some staff members to storage just to make sure that the documents were not inadvertently sent to storage, and they were not.

The employee personnel files on the legacy digital archiving system have been transferred to disc. There is a back up set of discs and they are also on the network. Additionally, the current procedures include scanning the documents into the imaging system at the same location that the paperwork was processed in order to decrease the time between processing and being available for viewing, and to reduce the risk of lost or misplaced documents. These files are backed up daily so that if any information is lost, it can be restored in a timely manner.

**STATUS OF PRIOR YEAR
MANAGEMENT LETTER COMMENTS**

CUTOFF

OBSERVATION

County departments are required to prepare and submit year-end accrual packages by July 15th to the County Administrative Office (CAO). The accrual packages include worksheets listing the amount, expenditure and/or object code, description of service, contract claim, invoice or reference number and the date that the item was received or service was rendered. The completion of this year-end closing procedure dictates the timing of the Auditor/Controller/Recorder's (ACR) preparation and completion of the Comprehensive Annual Financial Report (CAFR).

During our examination, it was noted that the ACR's office accelerated the timing and cutoff of accrual packages in order to complete the CAFR in a timely manner. However, it was noted that numerous accruals, primarily pertaining to accounts payable, were not recorded as a result of the accelerated timeline. There were significant liabilities for goods and services, including capital assets, received prior to year-end which had not been accrued in the respective year-end fund general ledgers, resulting in audit adjustments totaling \$6,400,000.

RECOMMENDATION

Although it is noted that formal written communication and training is performed on an annual basis by the ACR's office to properly provide year-end closing procedures to County departments, we recommend that the ACR implement additional procedures to ensure that material transactions are accrued in the proper period. These procedures should include the following:

- Departments should be instructed to estimate recurring monthly expenditures based on the best available information in order to ensure timely processing by the ACR's office.
- The ACR's office should utilize either internal auditors or general accounting personnel to perform testing procedures subsequent to the accounting year-end date to validate County departments' year-end estimates.
- Based on the outcome of these results, document and record necessary adjustments to the financial statements.

By implementing additional procedures, material transactions requiring accrual may be identified and corrected in a timely manner in order to facilitate the audit process and issuance of the County's CAFR.

STATUS

Implemented

RECONCILIATION OF SPECIAL DISTRICTS FIXED ASSETS

OBSERVATION

The County's General Accounting Section implemented a centralized fixed assets subsidiary ledger in the prior year to comply with GASB 34 reporting requirements. We noted this subsidiary ledger is reconciled to the General Ledger and is used to prepare the County's Consolidated Annual Financial Report. We noted that the County's Internal Audit Division is responsible for providing to General Accounting adjustments to the fixed assets subsidiary ledger for the Special District Funds, through the annual audit of these Special Districts. During our examination of fixed assets it was noted that the schedules generated through the fixed assets subsidiary ledger, listing additions and deletions, could not be reconciled to the Special District reports. We noted multiple immaterial discrepancies.

RECOMMENDATION

The County's General Accounting department should implement procedures to ensure no post-closing adjustments to the fixed assets subsidiary ledger are performed after the annual accrual cut-off period. Any additional adjustments made to the subsidiary ledger for Special District Funds should be limited to audit adjustments proposed by the Internal Audit Division and the County's outside auditors.

STATUS

Implemented

FREQUENCY OF ACTUARIAL REPORTS

OBSERVATION

Over the past fiscal years, the County has made over \$50 million dollars in adjustments to their self-insurance reserves. These adjustments have resulted from the ever-increasing costs and claims related to workers' compensation. Currently, the County has an actuarial study performed by an outside consultant every two years. The actuary provides the County with estimated loss reserve balances for the first and second year based on prior year claim data. As such, historical claim data is currently not considered for the period when no actuarial study is performed. During the "off-year" that an actuarial study has not been obtained, the County's Risk Management Division performs an internal analysis which historically has decreased the County's Risk Management related liabilities.

RECOMMENDATION

Because of the volatility of the costs related to workers' compensation, we recommend that the County have an actuarial study performed on annual basis. By having this study performed annually, the most current claim data will be utilized by the actuary to project the needed reserves resulting in a more accurate accrual each year. In addition, this more frequent analysis will lend to the County being able to better assess their costs and charge the appropriate fees to each department on a timely basis.

At a minimum, the County should not adjust its risk management liabilities pertaining to "incurred but not reported" losses during the years where actuarial studies are not performed. This would result in a more conservative approach to recording these liabilities and prevent significant fluctuations in these liabilities between accounting periods.

STATUS

Partially Implemented. Annual actuarial study not implemented.

SEGREGATION OF DUTIES - PAYRATE OVERRIDE

OBSERVATION

During our test-work over the payroll process, we noted employees in Central Payroll have the ability to view and edit County employee pay rates. We understand, and agree the ability to view and adjust pay rates is necessary to accommodate certain types of employee leave integration. An exception report is generated each pay period that lists all instances of pay rate overrides, including the employee making the change. This report is subject to review by one EMACS system administrator – no secondary or upper management review is conducted. In addition, the system administrator reviewing the report also has the ability to override pay rates, including their own rate.

RECOMMENDATION

We recommend that upper management periodically review the pay rate override exception report to ensure no improprieties exist. Additionally, the County should implement restricted access within its payroll system to ensure only a select few employees in Central Payroll have the ability to adjust employee pay rates. The above recommendation will improve the control of pay rate adjustments and assure employees are paid according to the approved rate.

STATUS

Implemented

FEDERAL AWARD REPORTING

OBSERVATION

During our examination of the County's procedures of compiling the Schedule of Expenditures of Federal Awards (SEFA) under the Office of Management and Budget (OMB) Circular A-133, it was noted that revenues are not consistently recorded between federal and state sources. In several circumstances, it was noted that federal revenue amounts were recorded within state revenue source object codes and visa versa. Although this practice does not misstate the County's revenues at the financial statement level, it does allow for the potential misstatement of expenditures under federal reporting requirements.

RECOMMENDATION

We recommend that the County modify its procedures to classify current year revenues to be based on the proper allocation to either federal or state revenue source object codes. By implementing such a procedure, this would streamline the reporting process required under OMB Circular A-133 and provide additional control over the presentation of the SEFA.

STATUS

Partially Implemented

GANN LIMIT

OBSERVATION

During our testing of the County's annual appropriation limit pursuant to Article XIII-B of the California Constitution, it was noted that the annual inflation and population factors were not explicitly identified in the Board of Supervisor resolution adopting the current year limit.

RECOMMENDATION

We recommend that the inclusion of the population and inflation factors be explicitly identified in the Board of Supervisor resolution to ensure compliance with the GANN limit requirements of the California Constitution.

STATUS

Implemented

NEW GASB POUNDNCEMENTS- INFORMATIONAL ONLY

In March 2003, GASB issued Statement No. 40, "*Deposit and Investment Risk Disclosures - an amendment of GASB Statement No. 3.*" This statement addresses common deposit and investment risks related to credit risks, concentration of credit risk, interest rate risk, and foreign currency risk and is effective for fiscal periods beginning after June 15, 2004.

As an element of interest rate risk, this statement requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates.

Deposit and investment policies related to the risks identified in this statement also should be disclosed.

Our audit procedures are designed primarily to enable us to form an opinion on the financial statements, and therefore may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of the County gained during our work to make comments and suggestions that we hope will be useful to you.

We would be pleased to discuss these comments and recommendations with you at any time.

This report is intended solely for the information and use of the Board of Supervisors, management, and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

Vavunick, Trine, Day & Co., LLP

Rancho Cucamonga, California
December 19, 2004